STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

Verizon North Inc. (f/k/a GTE North Incorporated) and Verizon South Inc. (f/k/a GTE South Incorporated)	:	
	:	**Docket No. 00-0812**
Petition seeking approval of Cost Studies for Unbundled Network Elements, Avoided Costs, and Intrastate Switched Access Services	:	

SECOND SUPPLEMENTAL BRIEF OF THE STAFF OF THE ILLINOIS COMMERCE COMMISSION

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On January 28, 2004, the Administrative Law Judge (hereafter "ALJ") issued an order directing the parties to file Second Supplemental Briefs addressing the following issue:

> Has the FCC in its NPRM affirmed the commitment to UNE rates based upon the forward looking costs of providing such services as the incumbent's network is able to support?
>
> ALJ Order at 1

The Staff assumes that "NPRM" refers to the FCC's *Notice of Proposed Rulemaking*, In the Matter of Review of the Commission's Rules Regarding the Pricing of Unbundled Network Elements and the Resale of Service by Incumbent Local Exchange Carriers, FCC No. 03-224, WC Docket No. 03-173 (September 10, 2003: Adopted; September 15, 2003: released)(hereafter "NPRM").

That the FCC has affirmed its commitment to UNE rates based upon forward-looking costs is beyond question. In the NPRM, the FCC stated as follows:

> Before addressing the detailed issues related to UNE pricing, we first must determine whether to alter the Commission's fundamental decision to use a methodology that sets prices on the basis of the forward-looking cost of providing UNEs. Although some incumbent LECs continue to press for UNE rates based on an historical cost methodology, in this proceeding **we reaffirm our commitment to forward-looking costing principles**. As the Supreme Court has made clear, an approach based on forward-looking cost is an entirely reasonable approach to follow under section 252(d)(1). [fn]
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> …
>
> **We conclude that our decision remains sound to base UNE prices on the forward-looking cost of providing UNEs.** This approach is supported both by the Supreme Court's endorsement of our forward-looking cost methodology and its concerns regarding alternative pricing methodologies that rely in whole or in part on embedded costs. We also note the general absence of criticism

> showing that a forward-looking costing methodology *per se* is flawed or unreasonable. Accordingly, we decline to open an inquiry into alternative pricing theories. …[.]
>
> NPRM, ¶¶29, 37 (emphasis added; footnote omitted)

This, however, answers no more than half of the question the ALJ poses. The remainder of the question appears to the Staff to go to the issue of what sort of network such forward-looking costing principles should assume to exist: the most efficient and sophisticated network available, or one more consistent with the actual attributes of the ILEC network for which UNE rates are being set. In the Staff's opinion, the FCC has decided – tentatively,[1] it must be said – to adopt the latter course.

The FCC faces squarely the precise matter at issue here. As a starting point, the FCC notes that: "Our current rules require states to assume that the "most efficient telecommunications technology currently available" is used throughout the network." NPRM, ¶69. The FCC recognizes that this is, and has been, a matter of contention, stating that: "Perhaps the most controversial aspect of the TELRIC rules is the assumption that the cost of a UNE should be

[1] It must be remembered that the FCC does not, in the NPRM (by definition), actually adopt rules. Rather, it reaches a number of tentative conclusions and solicits comment from interested parties on the propriety of those conclusion and such other issues as might bear upon its ultimate decision. The Commission has filed its Comments with the FCC in this matter; although the comment cycle is complete, the FCC has not issued rules, and it is uncertain when such rules will be issued. Moreover, there appears to be some substantial disagreement among the Federal Communications Commissioners regarding the propriety of this tentative conclusion. *See* Statement of Commissioner Michael J. Copps, Approving in Part and Dissenting in Part ("I regret, however, that I cannot support today's Notice of Proposed Rulemaking *en toto*. I just don't believe the record at hand justifies the making of important, even if tentative, conclusions. … On the basis of little or no prior record, the majority today adopts a tentative conclusion concerning so-called real-world network attributes that I believe is confusing and inconsistent with basic premises of TELRIC that were upheld as a reasonable interpretation of Section 252(d)(1) by the Supreme Court.")

calculated based on the cost of ubiquitous deployment of the most efficient technology currently available.” NPRM, ¶49. The FCC also recognizes that:

> One of the central internal tensions in the application of the TELRIC methodology is that it purports to replicate the conditions of a competitive market by assuming that the latest technology is deployed throughout the hypothetical network, while at the same time assuming that this hypothetical network benefits from the economies of scale associated with serving all of the lines in a study area.
>
> Id., ¶50

The FCC further notes that, the merits of TELRIC principles notwithstanding, aspects of the TELRIC rules may well be based on questionable premises. For example, the FCC finds the assumed instantaneous deployment of most advanced, least cost technology to be particularly dubious, stating as follows:

> [I]t is unlikely that any carrier, no matter how competitive the marketplace, would deploy new technology instantaneously and ubiquitously throughout its network. Even if the objective is to replicate the results of a competitive market, an approach that reconstructs the network over time seems to be more appropriate than one that assumes the instantaneous deployment of 100 percent new technology.
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> NPRM, ¶68

Likewise, observes the FCC, the requirement that a TELRIC model assume ubiquitous, most advanced technology might well assume economic conditions at considerable variance with those that actually exist, and might therefore provide improper investment incentives to carriers. Id., ¶¶50-51. Based upon these considerations, the FCC “tentatively conclude[s] that [its] **TELRIC rules should more closely account for the real-world attributes of the routing and topography of an incumbent’s network in the development of**

forward-looking costs." Id., ¶52 (emphasis added). The FCC observes that, under the approach it tentatively adopts:

> [T]he **UNE pricing methodology**, while forward-looking, **must be representative of the real world** and should not be based on the totally hypothetical cost of a most-efficient provider building a network from scratch. To that end, the UNE cost study should be based upon the incumbent LEC's actual network topography and currently available, forward-looking technologies.
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> NPRM, ¶53 (emphasis added)

As an alternative to its tentative conclusion, the FCC solicits comment upon the question of whether new cost rules should assume that: "[T]he relevant network [is] one that that incorporates upgrades planned by the incumbent LEC over some objective time horizon (*e.g.*, three or five years), as documented, for example, in an incumbent LEC's actual engineering plans." Id., ¶54. The FCC expands upon such an approach, stating that:

> Although this approach would take as given whatever existing facilities will remain in the network at the end of the designated period, it also should capture technological evolution within that period. Such an approach may provide an appropriate middle ground between the hypothetical assumptions required under our current rules and the replacement cost approach described in the previous paragraph.
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> Id.

What emerges from this is the fact that the FCC appears likely to adopt one of two methodologies for the derivation of forward-looking costs, the first assuming actual, existing, attributes of the incumbent's actual network, and the second assuming those attributes that the incumbent plans to incorporate into its network over the coming three to five years. Both of these network assumptions are grounded in the real world, either as it exists currently, or as planned. Neither assumes a best-available technology, gold-plated network.[2]

This conclusion is buttressed by other references in the NPRM. For example, the FCC observes, with respect to its *USF Inputs Order*, that:

> In developing the model and inputs necessary to calculate universal service funding, the Commission did not intend to provide any systematic guidance to states in the area of TELRIC rate-setting. Indeed, the Commission emphasized at the time that its decisions on particular inputs were made solely for the purpose of calculating universal service support and may not be appropriate for the calculation of UNE prices. [fn] For these reasons, we continue to discourage states from using the nationwide inputs for the purpose of developing UNE prices.
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> …
>
> Applying [a] particular statement from the *USF Inputs Order* out of context erroneously assumes away not just the features of an incumbent LEC's existing network but also attributes of the real world in which incumbents and competitors operate.
>
> **Our approach is … to suggest more broadly that imposing some real-world boundaries on the UNE cost inquiry is needed to ensure that appropriate pricing signals are sent to the market**. …[.]
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> NPRM, ¶¶46-48 (emphasis added)

In other words, the FCC appears to be moving towards a method of estimating forward looking UNE costs that takes greater account of the characteristics of the network that is being used to provide the UNEs in question. The FCC's tentative conclusion that the "TELRIC rules should more closely account for the real-world attributes of the routing and topography of an incumbent's network in the development of forward-looking costs[,]" NPRM, ¶52; its

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2 As the Staff made clear in its several Briefs in this proceeding, Verizon's ICM Model assumes precisely such a network.

proposed alternative methodology that incorporates proposed upgrades over a three to five year planning period, and its cautionary statement to state Commissions regarding the applicability of the USF Inputs Order, which models a very forward-looking network, all confirm this conclusion.

However, it must be stressed that very nearly everything the FCC stated in its NPRM is of a tentative, preliminary nature. The FCC may adopt rules that are completely at odds with the statements it makes, and tentative conclusions that it reaches, in its NPRM. Further, the FCC's current rules remain binding at this time. It would, therefore, be imprudent to act based upon the NPRM.

WHEREFORE, the Staff of the Illinois Commerce Commission submits this Second Supplementary Brief in this proceeding

Respectfully submitted,

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